

ORIGINAL

MEMORANDUM



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TO: Docket Control

FROM: Ernest G. Johnson
Director
Utilities Division

EA for EGT

DATE: April 30, 2008

RE: IN THE MATTER OF THE APPLICATION OF AMERICAN FIBER NETWORK, INC. FOR APPROVAL TO PROVIDE RESOLD LOCAL EXCHANGE TELECOMMUNICATIONS SERVICES AS WELL AS FACILITIES BASED LOCAL EXCHANGE TELECOMMUNICATIONS SERVICES (DOCKET NO. T-03815A-06-0747)

Attached is the Staff Report for the above referenced Application. The Applicant is applying for approval to provide the following services:

- Facilities-Based Local Exchange Services
- Switched Access Services

Staff is recommending approval of the Application.

EGJ:PJG:red

Originator: Pamela J. Genung

Attachment: Original and Thirteen copies

Arizona Corporation Commission
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SERVICE LIST FOR: AMERICAN FIBER NETWORK, inC.
DOCKET NO.: T-03815A-06-0747

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STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

AMERICAN FIBER NETWORK, INC.

DOCKET NO. T-03815A-06-0747

IN THE MATTER OF THE APPLICATION OF AMERICAN FIBER NETWORK, INC. FOR
APPROVAL TO PROVIDE RESOLD LOCAL EXCHANGE TELECOMMUNICATIONS
SERVICES AS WELL AS FACILITIES BASED LOCAL EXCHANGE
TELECOMMUNICATIONS SERVICES

APRIL 30, 2008

STAFF ACKNOWLEDGMENT

The Staff Report for American Fiber Network, Inc., Docket No. T-03815A-06-0747, was the responsibility of the Staff member listed below. Pamela J. Genung was responsible for the review and analysis of American Fiber Network, Inc.'s Application for a Certificate of Convenience and Necessity to provide Facilities-based Local Exchange and Switched Access Telecommunications Services within the State of Arizona and a petition for a determination that its proposed services should be classified as competitive.

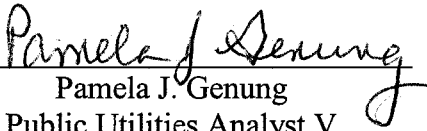

Pamela J. Genung
Public Utilities Analyst V

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ATTACHMENT

States In Which AFN's Affiliates Are Currently Certificated..... Attachment A

1. INTRODUCTION

On November 29, 2006, American Fiber Network, Inc. ("AFN" or "Applicant") filed an Application for a Certificate of Convenience and Necessity ("CC&N") to provide resold local exchange and facilities-based local exchange telecommunications services within the State of Arizona. The Applicant also petitioned the Arizona Corporation Commission ("Commission") for a determination that its proposed services should be classified as competitive. On November 29, 2006, AFN submitted a proposed tariff for the services it is requesting the authority to provide.

On May 1, 2007, Staff issued its First Set of Data Requests to AFN. On May 30, 2007, AFN filed its responses to Staff's First Set of Data Requests, in addition to a revision to its proposed tariff. On August 10, 2007, Staff issued its Second Set of Data Requests to AFN.

Commission records indicate that on June 28, 2001, in Decision No. 63837, AFN was granted authority to provide competitive resold local exchange telecommunications services conditioned upon procurement of a \$25,000 performance bond and filing of its tariff. Through a series of communications between Staff and the Applicant, AFN was brought into compliance with the filing of its performance bond on August 15, 2007 and its tariff on October 12, 2007.

On November 19, 2007, AFN filed an amended Application for a CC&N requesting authority to provide only facilities-based local exchange telecommunications services within the State of Arizona. AFN also submitted updated financial information and a revision to its proposed tariff in the amended Application.

On December 7, 2007, AFN filed its responses to Staff's Second Set of Data Requests. In addition, on December 7, 2007 AFN amended page 2 of its revised Application to specify that it intends to provide switched access telecommunications services. Therefore, the subject of this Application is AFN's request for authority to provide facilities-based local exchange and switched access services within the State of Arizona.

Staff's review of this Application addresses the overall fitness of the Applicant to receive a CC&N. Staff's analysis also considers whether the Applicant's services should be classified as competitive and if the Applicant's initial rates are just and reasonable.

2. TECHNICAL CAPABILITY TO PROVIDE THE REQUESTED SERVICES

AFN indicated that it is currently providing competitive facilities-based local exchange telecommunications services in 28 States (See Attachment A). Staff has contacted each of the Public Utility Commissions in those 28 States/Jurisdictions to determine if AFN is certificated or registered to provide telecommunications services in the states listed by the Applicant. Staff also inquired whether there were any consumer

complaints filed against the Applicant. The information that Staff has obtained indicates that there have been no consumer complaints filed against AFN in any of the other States/Jurisdictions in which AFN is authorized to provide telecommunications services.

In response to Staff's Data Requests, AFN has indicated that it is also currently providing resold local exchange telecommunications services in the State of Arizona under the authority of Decision No. 63837 dated June 28, 2001. In addition, AFN is currently providing resold long distance telecommunications services within the State of Arizona under the authority of Decision No. 62718 dated June 30, 2000. Based on this information, Staff believes AFN possesses the technical capabilities to provide the services it is requesting the authority to provide.

3. FINANCIAL CAPABILITY TO PROVIDE THE REQUESTED SERVICES

The Applicant provided updated unaudited financial statements of American Fiber Network for the twelve months ending March 31, 2006, and twelve months ending March 31, 2007. Additional financial statements for the period ending September 30, 2007 were also provided. The financial statements ending March 31, 2006 lists total assets of \$1,759,223; total equity of \$468,413; and net income of \$1,763,287. The financial statements ending March 31, 2007 lists total assets of \$2,176,369; total equity of \$923,955; and net income of \$473,624. Meanwhile, the financial statements for the period ending September 30, 2007 indicate total assets of \$2,352,123; total equity of \$1,440,168; and net income of \$516,183. The Applicant provided notes related to the financial statements.

The Applicant has filed proposed tariff pages to include in its current approved Arizona Tariff No. 1 representing the new services it is requesting authorization to provide in the State of Arizona. In its Arizona Tariff No. 1, under Terms and Conditions (reference Section 2.1.3 on Original Page 8) the Applicant does not specify a requirement for its customers to pay deposits but it does indicate that payments for service are due in advance.

Staff believes that advances, deposits, and/or prepayments received from the Applicant's customers should be protected by the procurement of either a performance bond or an irrevocable sight draft Letter of Credit. The Applicant is requesting a CC&N to provide facilities-based local exchange and switched access telecommunications services. The Commission's current bond or irrevocable sight draft Letter of Credit requirements are \$10,000 for resold long distance, \$25,000 for resold local exchange, \$100,000 for facilities-based long distance, and \$100,000 for facilities-based local exchange services. In compliance with Decision No. 63837, which authorized AFN to provide resold Local exchange service in Arizona, AFN has a \$25,000 performance bond on file with this Commission. The minimum, additional amount of a bond or sight draft letter of credit coverage needed for facilities-based local exchange service is \$100,000. Therefore, the Applicant's current bond needs to be increased by \$100,000. The bond or draft coverage needs to increase in increments equal to 50 percent of the total minimum bond or irrevocable sight draft Letter of Credit amount when the total amount of the

advances, deposits, and prepayments is within 10 percent of the total minimum bond or draft amount. Further, measures should be taken to ensure that the Applicant will not discontinue service to its customers without first complying with Arizona Administrative Code ("A.A.C.") R14-2-1107.

To that end, Staff recommends that the Applicant procure either a performance bond or an irrevocable sight draft Letter of Credit equal to \$125,000. The minimum bond or draft amount of \$125,000 should be increased if at any time it would be insufficient to cover advances, deposits, and/or prepayments collected from the Applicant's customers. The bond or draft amount should be increased in increments of \$62,500. This increase should occur when the total amount of the advances, deposits, and prepayments is within \$12,500 of the bond or draft amount. If the Applicant desires to discontinue service, it must file an Application with the Commission pursuant to A.A.C. R14-2-1107. Additionally, the Applicant must notify each of its customers and the Commission 60 days prior to filing an Application to discontinue service. Failure to meet this requirement should result in forfeiture of the Applicant's performance bond or irrevocable sight draft Letter of Credit.

Staff further recommends that proof of the above mentioned performance bond or irrevocable sight draft Letter of Credit be docketed within 30 days of the effective date of a Decision in this matter. The original bond or Letter of Credit should be filed with the Commission's Business Office and copies of the bond or Letter of Credit with Docket Control, as a compliance item in this docket. The Commission may draw on the bond or Letter of Credit, on behalf of, and for the sole benefit of the Company's customers, if the Commission finds, in its discretion, that the Company is in default of its obligations arising from its Certificate. The Commission may use the bond or Letter of Credit funds, as appropriate, to protect the Company's customers and the public interest and take any and all actions the Commission deems necessary, in its discretion, including, but not limited to returning prepayments or deposits collected from the Company's customers.

4. ESTABLISHING RATES AND CHARGES

The Applicant would initially be providing service in areas where an incumbent local exchange carrier ("ILEC"), along with various competitive local exchange carriers ("CLECs") and interexchange carriers are providing telephone service. Therefore, the Applicant would have to compete with those providers in order to obtain subscribers to its services. The Applicant would be a new entrant and would face competition from both an incumbent provider and other competitive providers in offering service to its potential customers. Therefore, the Applicant would generally not be able to exert market power. Thus, the competitive process should result in rates that are just and reasonable.

Both an initial rate (the actual rate to be charged) and a maximum rate must be listed for each competitive service offered, provided that the rate for the service is not less than the Company's total service long-run incremental cost of providing the service pursuant to A.A.C. R14-2-1109.

The rates proposed by this filing are for competitive services. In general, rates for competitive services are not set according to rate of return regulation. Staff obtained information from AFN indicating that its fair value rate base is zero. Accordingly, AFN's fair value rate base is too small to be useful in a fair value analysis. On November 29, 2006, AFN submitted proposed tariff pages reflecting the actual rates that AFN will be charging for its local exchange and switched access services. On May 30, 2007 and subsequently on November 19, 2007, AFN submitted revised tariff pages to amend its initially proposed tariff. On December 7, 2007, AFN provided additional rate comparison information of other competitive local exchange carriers in the State of Arizona. Staff has reviewed these rates and believes they are comparable to the rates charged by competitive local carriers and local incumbent carriers operating in the State of Arizona. Therefore, while Staff considered the fair value rate base information submitted by the company, the fair value rate base information provided should not be given substantial weight in this analysis.

5. LOCAL EXCHANGE CARRIER SPECIFIC ISSUES

Issues related to the provision of Local Exchange service are discussed below.

5.1 NUMBER PORTABILITY

The Commission has adopted rules to address number portability in a competitive telecommunications services market. Local exchange competition may not be vigorous if customers, especially business customers, must change their telephone numbers to take advantage of a competitive local exchange carrier's service offerings. Consistent with federal laws, federal rules and A.A.C. R14-2-1308(A), the Applicant shall make number portability available to facilitate the ability of a customer to switch between authorized local carriers within a given wire center without changing their telephone number and without impairment to quality, functionality, reliability or convenience of use.

5.2 PROVISION OF BASIC TELEPHONE SERVICE AND UNIVERSAL SERVICE

The Commission has adopted rules to address universal telephone service in Arizona. A.A.C. R14-2-1204(A) indicates that all telecommunications service providers that interconnect into the public switched network shall provide funding for the Arizona Universal Service Fund ("AUSF"). The Applicant will make the necessary monthly payments required by A.A.C. R14-2-1204(B).

5.3 QUALITY OF SERVICE

Staff believes that the Applicant should be ordered to abide by the quality of service standards that were approved by the Commission for Qwest Corporation (f/k/a USWC) in Docket No. T-01051B-93-0183 (Decision No. 59421). Because the penalties developed in that docket were initiated because Qwest's level of service was not satisfactory and the Applicant does not have a similar history of service quality problems, Staff does not recommend that those penalties apply to the Applicant. In the competitive

market that the Applicant wishes to enter, the Applicant generally will have no market power and will be forced to provide a satisfactory level of service or risk losing its customers. Therefore, Staff believes that it is unnecessary to subject the Applicant to those penalties at this time.

5.4 ACCESS TO ALTERNATIVE LOCAL EXCHANGE SERVICE PROVIDERS

Staff expects that there will be new entrant providers of local exchange service who will install the plant necessary to provide telephone service to, for example, a residential subdivision or an industrial park much like existing local exchange companies do today. There may be areas where the Applicant installs the only local exchange service facilities. In the interest of providing competitive alternatives to the Applicant's local exchange service customers, Staff recommends that the Applicant be prohibited from barring access to alternative local exchange service providers who wish to serve such areas. This way, an alternative local exchange service provider may serve a customer if the customer so desires. Access to other providers should be provided pursuant to the provisions of the 1996 Telecommunications Act, the rules promulgated there under and Commission rules on interconnection and unbundling.

5.5 911 SERVICE

The Commission has adopted rules to address 911 and E911 services in a competitive telecommunications services market. The Applicant has certified that in accordance with A.A.C. R14-2-1201(6)(d) and Federal Communications Commission 47 CFR Sections 64.3001 and 64.3002, it will provide all customers with 911 and E911 service, where available, or will coordinate with ILECs and emergency service providers to provide 911 and E911 service.

5.6 CUSTOM LOCAL AREA SIGNALING SERVICES

Consistent with past Commission decisions, the Applicant may offer Caller ID provided that per call and line blocking, with the capability to toggle between blocking and unblocking the transmission of the telephone number, are provided as options to which customers could subscribe with no charge. Also, Last Call Return service that will not return calls to telephone numbers that have the privacy indicator activated, indicating that the number has been blocked, must be offered.

6. REVIEW OF COMPLAINT INFORMATION

The Applicant has neither had an application for service denied, nor revoked in any state. There are, and have been, no formal complaint proceedings involving the Applicant. There have not been any civil or criminal proceedings against the Applicant. The Corporations Section has indicated that AFN is in good standing and the Consumer Services Section reports no complaints have been filed in Arizona from January 1, 2003 to January 28, 2008.

The Applicant indicated that none of its officers, directors or partners have been involved in any civil or criminal investigations, or any formal or informal complaints. The Applicant also indicated that none of its officers, directors or partners have been convicted of any criminal acts in the past ten (10) years.

7. COMPETITIVE SERVICES ANALYSIS

The Applicant has petitioned the Commission for a determination that the services it is seeking to provide should be classified as competitive.

7.1 COMPETITIVE SERVICES ANALYSIS FOR LOCAL EXCHANGE SERVICES

7.1.1 A description of the general economic conditions that exist, which makes the relevant market for the service one that, is competitive.

The local exchange market that the Applicant seeks to enter is one in which a number of new CLECs have been authorized to provide local exchange service. Nevertheless, ILECs hold a virtual monopoly in the local exchange service market. At locations where ILECs provide local exchange service, the Applicant will be entering the market as an alternative provider of local exchange service and, as such, the Applicant will have to compete with those companies in order to obtain customers. In areas where ILECs do not serve customers, the Applicant may have to convince developers to allow it to provide service to their developments.

7.1.2 The number of alternative providers of the service.

Qwest and various independent LECs are the primary providers of local exchange service in the State. Several CLECs and local exchange resellers are also providing local exchange service.

7.1.3 The estimated market share held by each alternative provider of the service.

Since Qwest and the independent LECs are the primary providers of local exchange service in the State, they have a large share of the market. Since the CLECs and local exchange resellers have only recently been authorized to offer service they have limited market share.

7.1.4 The names and addresses of any alternative providers of the service that are also affiliates of the telecommunications Applicant, as defined in A.A.C. R14-2-801.

None.

- 7.1.5 The ability of alternative providers to make functionally equivalent or substitute services readily available at competitive rates, terms and conditions.

ILECs have the ability to offer the same services that the Applicant has requested in their respective service territories. Similarly many of the CLECs and local exchange resellers also offer substantially similar services.

- 7.1.6 Other indicators of market power, which may include growth and shifts in market share, ease of entry and exit, and any affiliation between and among alternative providers of the service(s).

The local exchange service market is:

- a. One in which ILECs own networks that reach nearly every residence and business in their service territories and which provide them with a virtual monopoly over local exchange service. New entrants are also beginning to enter this market.
- b. One in which new entrants will be dependent upon ILECs:
 1. To terminate traffic to customers.
 2. To provide essential local exchange service elements until the entrant's own network has been built.
 3. For interconnection.
- c. One in which ILECs have had an existing relationship with their customers that the new entrants will have to overcome if they want to compete in the market and one in which new entrants do not have a long history with any customers.
- d. One in which most customers have few, if any choices since there is generally only one provider of local exchange service in each service territory.
- e. One in which the Applicant will not have the capability to adversely affect prices or restrict output to the detriment of telephone service subscribers.

8. RECOMMENDATIONS

The following sections contain the Staff recommendations on the Application for a CC&N and the Applicant's petition for a Commission determination that its proposed services should be classified as competitive.

8.1 RECOMMENDATIONS ON THE APPLICATION FOR A CC&N

Staff recommends that Applicant's Application for a CC&N to provide facilities-based local exchange and switched access services, be granted. In addition, Staff further recommends:

1. That the Applicant be required to comply with all Commission Rules, Orders and other requirements relevant to the provision of intrastate telecommunications services;
2. That the Applicant be required to abide by the quality of service standards that were approved by the Commission for Qwest in Docket No. T-01051B-93-0183;
3. That the Applicant be prohibited from barring access to alternative local exchange service providers who wish to serve areas where the Applicant is the only provider of local exchange service facilities;
4. That the Applicant be required to notify the Commission immediately upon changes to the Applicant's name, address or telephone number;
5. That the Applicant be required to cooperate with Commission investigations including, but not limited to customer complaints;
6. The rates proposed by this filing are for competitive services. In general, rates for competitive services are not set according to rate of return regulation. Staff obtained information from the company and has determined that its fair value rate base is zero. Staff has reviewed the rates to be charged by the Applicant and believes they are just and reasonable as they are comparable to other competitive local carriers, local incumbent carriers and major long distance companies offering service in Arizona and comparable to the rates the Applicant charges in other jurisdictions. The rate to be ultimately charged by the company will be heavily influenced by the market. Therefore, while Staff considered the fair value rate base information submitted by the company, the fair value information provided was not given substantial weight in this analysis;
7. That the Applicant offer Caller ID with the capability to toggle between blocking and unblocking the transmission of the telephone number at no charge;
8. That the Applicant offer Last Call Return service that will not return calls to telephone numbers that have the privacy indicator activated;
9. That the Commission authorize the Applicant to discount its rates and service charges to the marginal cost of providing the services;

10. That the Applicant be required to submit conforming local exchange service and switched access service tariffs pages;

Staff further recommends that the Applicant be ordered to comply with the following. If it does not do so, the Applicant's CC&N shall be null and void after due process.

1. The Applicant shall docket conforming tariff pages for each service within its CC&N within 365 days from the date of an Order in this matter or 30 days prior to providing service, whichever comes first. The tariffs submitted shall coincide with the Application.

2. The Applicant shall:

- a. Procure either a performance bond or an irrevocable sight draft Letter of Credit equal to \$125,000. The minimum bond or draft amount of \$125,000 should be increased if at any time it would be insufficient to cover advances, deposits, and/or prepayments collected from the Applicant's customers. The bond or draft amount should be increased in increments of \$62,500. This increase should occur when the total amount of the advances, deposits, and prepayments is within \$12,500 of the bond or draft amount.
- b. Docket proof of the performance bond or irrevocable sight draft Letter of Credit within 30 days of the effective date of a Decision in this matter. The original bond or Letter of Credit shall be filed with the Commission's Business Office and copies of the bond or Letter of Credit with Docket Control, as a compliance item in this docket. The performance bond or irrevocable sight draft Letter of Credit must remain in effect until further order of the Commission.

The Commission may draw on the bond or Letter of Credit, on behalf of, and for the sole benefit of the Company's customers, if the Commission finds, in its discretion, that the Company is in default of its obligations arising from its Certificate. The Commission may use the bond or Letter of Credit funds, as appropriate, to protect the Company's customers and the public interest and take any and all actions the Commission deems necessary, in its discretion, including, but not limited to returning prepayments or deposits collected from the Company's customers.

- c. If at some time in the future the Applicant does not collect advances, deposits and/or prepayments from its customers, Staff recommends that the Applicant be allowed to file a request for cancellation of its established performance bond or irrevocable sight draft Letter of Credit regarding its facilities-based and switched access telecommunications services. Staff recommends that the Commission require that such request reference the

Decision in this docket and explain the Applicant's plans for canceling those portions of the performance bond or irrevocable sight draft Letter of Credit.

3. The Applicant shall abide by the Commission adopted rules that address Universal Service in Arizona. A.A.C. R14-2-1204(A) indicates that all telecommunications service providers that interconnect into the public switched network shall provide funding for the Arizona Universal Service Fund ("AUSF"). The Applicant will make the necessary monthly payments required by A.A.C. R14-2-1204(B).

8.2 *RECOMMENDATION ON THE APPLICANT'S PETITION TO HAVE ITS PROPOSED SERVICES CLASSIFIED AS COMPETITIVE*

Staff believes that the Applicant's proposed services should be classified as competitive. There are alternatives to the Applicant's services. The Applicant will have to convince customers to purchase its services, and the Applicant has no ability to adversely affect the local exchange or interexchange service markets. Therefore, the Applicant currently has no market power in the local exchange or switched access service markets where alternative providers of telecommunications services exist. Staff therefore recommends that the Applicant's proposed services be classified as competitive.

Attachment A

The following are the states in which AFN is currently offering facilities-based local exchange telecommunications services similar to those it intends to offer in the State of Arizona:

1. Alabama
2. Arkansas
3. Colorado
4. Florida
5. Georgia
6. Hawaii
7. Idaho
8. Kansas
9. Kentucky
10. Louisiana
11. Michigan
12. Minnesota
13. Mississippi
14. Missouri
15. Montana
16. Nebraska
17. New Mexico
18. North Carolina
19. North Dakota
20. Oregon
21. South Carolina
22. South Dakota
23. Tennessee
24. Texas
25. Utah
26. Virginia
27. Washington
28. Wyoming